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In the Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

v.

AMERICAN SAVINGS BANK,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF FEDERAL NATIONAL MORTGAGE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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On Writ of Certiorari
to the United States Court of Appeals
For the Fifth Circuit

BRIEF OF
FEDERAL NATIONAL MORTGAGE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF AMICUS[1]

The Federal National Mortgage Association ("Fannie Mae") is a congressionally chartered, privately owned company created in 1938 to support housing finance by making a secondary market for residential mortgages. Fannie Mae fulfills its corporate mission by providing "ongoing assistance to the secondary market for home mortgages (including activities relating to mortgages on

[1] Pursuant to Supreme Court Rule 37.3, the Federal National Mortgage Association is filing its brief as amicus curiae with the consent of all the parties. The letters of consent are being filed with the Clerk simultaneously with the filing of this brief.

housing for low- and moderate-income families involving a reasonable economic return . . .)" and "by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing." 12 U.S.C. § 1716(3)-(4) (as amended by Pub. L. No. 102-550, § 1381, 106 Stat. 3672, 3994-95 (1992)).

Fannie Mae provides a secondary market for residential mortgage loans by purchasing such loans from a nationwide network of approximately 2,800 local mortgage lending institutions. Through its purchases, Fannie Mae replenishes lenders' supply of mortgage funds available for new loans. Fannie Mae has grown to be the nation's largest investor in home mortgages secured by properties for low-, moderate-, and middle-income families, and in the 1990s, expects to help well over 12 million American families buy homes. Fannie Mae purchases for its portfolio or holds in trust for investors one out of every four mortgages originated in the United States today.

Fannie Mae believes that the issue of Chapter 13 cramdowns is of great importance to the residential mortgage industry. Residential mortgages are more available and affordable than other types of consumer financing, in large part because residential property is inherently reliable collateral. If a mortgage loan may be bifurcated into secured and unsecured portions in the event that a borrower seeks relief under Chapter 13, lenders' confidence in this collateral will likely diminish.

Generally, the greatest obstacle to first-time home ownership is accumulating sufficient savings for a downpayment. Therefore, the key to home ownership for low- and

moderate-income borrowers, in particular, is the availability of low-downpayment mortgage financing. A lender will have less incentive to make high loan-to-value ratio loans if, in addition to foreclosure losses, the lender must anticipate a borrower's reducing home mortgage debt through a Chapter 13 bankruptcy filing whenever a temporary decline in housing values eliminates the borrower's equity. Thus, the potential of home mortgage cramdown in Chapter 13 could result in higher borrowing costs to prospective home owners overall, as well as tighter credit standards, making such financing more difficult to obtain, particularly for first-time and low-income buyers.

SUMMARY OF ARGUMENT

The plain language of section 1322(b)(2) mandates that a Chapter 13 plan may not alter the bargained-for rights of a home mortgage lender. By use of the word "claim" in the anti-modification clause of section 1322(b)(2), that section protects the home mortgage lender's full claim, as "claim" is defined in section 101(5)(A) of the Bankruptcy Code. The "rights" of the mortgage lender that are expressly exempt from modification under section 1322(b)(2) include not only the right of the lender to be paid what it is owed, but the right, in case of defaults, to foreclose on the property to recover as much as possible of the debt.

The legislative history of section 1322(b)(2) supports this reading of the plain language of the provision. Under the Bankruptcy Act, no claim secured by real estate of any type could be modified in a Chapter XIII wage-earner plan. While the 1977 House version of the proposed Bankruptcy Code proposed to eliminate this restriction, the 1978 Senate bill preserved it. Section 1322(b)(2), as enacted, represents

a compromise designed to afford special protection only to home mortgage lenders: claims secured by a security interest in a debtor's principal residence cannot be modified under a Chapter 13 plan.

Petitioners' contention that section 1322(b)(2) protects the lender's rights solely with respect to the secured portion of a claim bifurcated under section 506(a) is untenable. Applying section 506(a) to home mortgage debt would virtually nullify the protections of a lender's "rights" under section 1322(b)(2) since the lender would lose, among other things, the "right" to be paid what it is owed. The only sensible conclusion is that Congress included the anti-modification clause in section 1322(b) to prevent the application of section 506(a) to a home mortgagee's "claim." Thus, to the extent that the general provisions of section 506(a) conflict with the specific provision in section 1322(b)(2) prohibiting home mortgage cramdown, section 1322(b)(2) must govern.

If the language "a claim secured by" a security interest in section 1322(b)(2) is read to mean an "allowed secured claim," as that term is used in section 506(a), one must also read section 1322(b)(2) in light of section 506(d). As this Court stated in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), section 506(d) does not allow voiding a lien where a claim that is secured has been allowed. When a home mortgagee's claim is secured and has been allowed, section 506(d) does not permit reducing the lien for the full outstanding amount of the loan to the value of the property.

Reading section 1322(b)(2) to allow cramdown of the home mortgage in a Chapter 13 bankruptcy is inconsistent with the purposes of that provision and of Chapter 13: the

home mortgage lender is significantly harmed without other creditors, or the debtor during the pendency of the plan, realizing any corresponding benefit. If the debtor's residence rises in value, solely the debtor will profit from this increase. As this Court stated in *Dewsnup*, there is no evidence that Congress intended mortgage lenders to receive such treatment.

Finally, mortgage cramdown in Chapter 13 would result in significantly worse treatment of a mortgage lender in Chapter 13 than in a Chapter 7 or 11 case. Under Petitioners' reading of section 1322(b)(2), only in a Chapter 13 case could a mortgage lender involuntarily lose the full lien for which it bargained. Congress could not have intended such harmful results to home mortgage lenders whose "rights" were to be protected.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 1322(b)(2) OF THE BANKRUPTCY CODE PROVIDES THAT THE RIGHTS OF A HOME MORTGAGE LENDER WITH REGARD TO ITS FULL "CLAIM" MAY NOT BE MODIFIED IN A CHAPTER 13 PLAN.

A. Use of the term "claim" in the anti-modification clause must be read in light of the definition of "claim" in section 101(5)(A) of the Bankruptcy Code.

"[S]tatutory interpretation begins with the language of the statute itself." *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990); *see also Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985). The plain language of section 1322(b)(2) states that the

"rights" of a home mortgage lender regarding its "claim" -- the full claim, not merely the portion of that claim that may be an "allowed secured claim" under a section 506(a) bifurcation -- may not be modified under a Chapter 13 plan.

Section 1322 reads in pertinent part:

> (b) Subject to subsections (a) and (c) of this section, the plan may --
>
> . . . .
>
> (2) modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . .

11 U.S.C. § 1322(b)(2) (1988) (emphasis added).

In setting out its one exception to modification, section 1322(b)(2) does not speak of a "secured claim," which is the term used in section 506(a) to refer to one of the products of claim bifurcation under that section. Instead, section 1322(b)(2) expresses its exception by reference to a "claim secured only" by a security interest in the Chapter 13 debtor's home. At least one bankruptcy court has recognized and well articulated the difference between these two terms:

> The restriction on modification [in section 1322(b)(2)] is not limited to so much of the claim as is secured, but extends to the entire claim, secured or unsecured, provided that the security consists only of a security interest in the debtor's principal residence.

> Those who would read the protection of Section 1322(b)(2) as limited to the secured portion of a home mortgage confuse the term "secured claim" with the phrase "claim secured only" by a home mortgage and disregard the difference in the function of the word "secured" in the two phrases. . . . Even if the mortgage exceeds the value of the residence so that the claim is not a secured claim, in the sense of wholly secured, it is still correctly described (if the creditor holds no other security) as "secured only by" a residential mortgage.[2]

The commas bracketing the anti-modification clause further indicate that the term "claim" in that clause should be read in light of the definition of "claim" set out in section 101(5)(A) of the Bankruptcy Code to include both secured and unsecured portions of a claim. The commas result in a syntax that "demonstrates an intent to maintain the independence of the anti-modification language from the 'secured claims' language preceding it. . . . This reinforces the conclusion that § 101(5)(A)'s definition of 'claim,' which is broad enough to include both secured and unsecured portions held by a single creditor, should be applied to § 1322(b)(2)." *In re Etchin*, 128 B.R. 662, 668 (Bankr. W.D. Wisc. 1991).

Section 506(a) itself (which, along with section 506(d), gave rise to the issue faced by this Court in the Chapter 7 context in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992)), differentiates between the terms "a secured claim" and a

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[2] *In re Strober*, 136 B.R. 614, 619-20 (Bankr. E.D.N.Y. 1992).

"claim secured by" a security interest and uses them in the manner explained above. Section 506(a) reads as follows:

> (a) An allowed *claim* of a creditor *secured by a lien on property* in which the estate has an interest . . . *is a secured claim* to the extent of the value of such creditor's interest in the estate's interest in such property . . . *and is an unsecured claim* to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

11 U.S.C. § 506(a) (1988) (emphasis added). As the language of section 506 itself indicates, a "claim" secured by a lien on property may be broader than a "secured claim" and thus, "an allowed claim . . . secured by a lien on property" may consist of both "a secured claim" and an "unsecured claim."

In sum, the restriction, or anti-modification clause, of section 1322(b)(2) speaks of a "claim." A reading of the plain language of the anti-modification clause requires no reference to section 506. It is section 101 of the Bankruptcy Code, not section 506, which defines a "claim."[3]

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[3] Use of the word "claim" in the anti-modification clause of section 1322 is sufficient to indicate that the full claim is protected from modification, even absent a clause such as "notwithstanding section 506(a)" (as in section 1111(b)(2)). By way of example, section 363 provides that if property "subject to a lien that secures an allowed claim" is sold during a case or pursuant to a plan, the "holder of such claim" may bid and offset "such claim" against the bid. 11 U.S.C. § 363(k) (1988). There is no explicit clause in section 363(k) excepting the "allowed claim" from bifurcation under section 506(a) into secured and unsecured claims. Nonetheless, the legislative history indicates that the creditor may bid and offset its full claim. 124 Cong. Rec. H11093 (daily ed. September 28, 1978) (Rep. Edwards); 124 Cong. Rec. S17409 (daily ed. October 6, 1978) (Sen. DeConcini). *See, e.g.*, *Dewsnup*, 112 S. Ct. at 781, n.1 (Scalia, J., dissenting); *In re Realty Invs., Ltd.*, 72 B.R. 143, 146 (Bankr. C.D. Cal. 1987) (for bidding purposes, "allowed claim" is total claim without reference to value of property). Similarly, if "claim" in the anti-modification clause of section 1322(b)(2) is read in light of its definition in section 101, it is not necessary to add a phrase specifically excepting the operation of section 506(a). The phrase may be more necessary in section 1111(b)(2), where the provisions preceding that subsection discuss the conversion of a nonrecourse claim into a recourse claim.

B. The "rights" of a holder of a claim secured by the Chapter 13 debtor's home include the right to be paid in full, or in the alternative, the right to foreclose on the property to recover as much of the debt as possible.

Section 1322(b)(2) by its protection of the "rights of holders of" claims excepts from its reach modification of the rights of such holders, rather than merely modification of their claims. Therefore, as the Fifth Circuit stated, "even if the entirety of such a claim is not a secured claim (as per section 506(a)), the rights of a holder of such a claim may not be modified under section 1322(b)(2)." *In re Nobleman*, 968 F.2d 483, 488 (5th Cir. 1992). Transforming secured debt into unsecured debt and eliminating the lender's right to look to the property securing its loan for full repayment in the event that the borrower does not pay strikes at the heart of the secured transaction and alters the bargain of the lender and borrower *ex post facto*.

Petitioners read section 1322(b)(2) as obliging the Chapter 13 debtor to live up to the full bargain struck with the home mortgage lender -- except as to the most fundamental term of the transaction, the repayment of the amount due to the lender. As Section II. of this brief indicates, Congress intended to protect home mortgage lenders through the

anti-modification clause of section 1322(b)(2). To read the clause as protecting only that portion of a lender's claim that is an "allowed secured claim" pursuant to section 506(a) results in negligible protection for the secured lender compared to what is lost through claim bifurcation and lienstripping.

Petitioners and their amici point out that, under their interpretation of section 1322, the Chapter 13 debtor must continue to pay interest at the contractual rate and to make the full monthly payment required under the loan agreement, but only until the lender has received the value of the collateral, as fixed by the bankruptcy court, plus interest. They then contend that the lender loses the right to receive anything further and must release its lien on the property. Petitioners argue that this reading of section 1322(b)(2) recognizes and achieves the special protection that Congress intended to afford home mortgage lenders.[4]

Protection of the interest rate, amount of installment payments, and other loan requirements is virtually meaningless in comparison to the rights the secured home lender is obliged to forego.[5] As this Court has recognized, a

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[4] Under section 1325(a)(5), other secured creditors whose claims are modified by the debtor and paid out over time will receive interest at the prevailing market rate. 11 U.S.C. § 1325(a)(5) (1988). Under section 1322(b)(2), the home mortgagee will receive no more than the contractual rate. Thus, under Petitioners' interpretation of section 1322(b)(2), a home mortgage lender could find its secured claim reduced, its lien stripped down, and its interest fixed at less than market rate even though other secured creditors, not "protected" by section 1322(b)(2), are receiving a prevailing rate of interest on their claims.

[5] Petitioners note that one of the advantages to the debtor of mortgage cramdown and lienstripping is that refinancing becomes possible. *See* Petitioners' Brief at 8. Thus the protections that Petitioners assert for a lender's interest rate and amount of monthly payment are ephemeral and therefore a virtual nullity.

mortgage lender bargains for the right to look to the property in question for full payment if the borrower does not pay. "[T]he creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee." *Dewsnup*, 112 S. Ct. at 778. In taking a security interest in real property, the mortgagee runs the risk that the property may fluctuate in value. Petitioners would have this Court hold that, if the property declines in value, the debtor can reduce the mortgage debt to that level and deprive the mortgagee of any benefit of a later increase in value. This Court specifically rejected that argument in the Chapter 7 context in *Dewsnup*. "Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain." *Id.*[6]

This plain language reading of section 1322(b)(2) with regard to the rights of a home mortgage lender demonstrates that mortgage cramdown is impermissible because such cramdown alters fundamental rights of a home mortgage lender with respect to its claim that Congress stated were to be protected.

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[6] Furthermore, as Section IV. of this brief points out, the significant harm to the rights of the home lender is not balanced by a corresponding benefit to other creditors; *only* the Chapter 13 debtor will benefit from a later increase in the value of the home.

II. THE LEGISLATIVE HISTORY SUPPORTS THE PLAIN LANGUAGE READING OF SECTION 1322(b)(2).

A. The legislative history of section 1322(b)(2) shows that, with respect to home mortgage debt, Congress intended to continue the pre-Code practice that prohibited modification of a claim secured by real estate.

A reading of section 1322(b)(2) that recognizes the protection accorded to the rights of a home mortgage lender is confirmed by the legislative history.

Under Chapter XIII of the Bankruptcy Act, the predecessor of the current Chapter 13, a wage earner's plan of reorganization could not "deal with" any claim secured by real property.[7] A 1973 draft of the Bankruptcy Code proposed by the Commission on the Bankruptcy Laws of the United States recast the language on this point but continued the Chapter XIII practice.[8] The House version of the

[7] *See* The Bankruptcy Act of 1898, Pub. L. No. 61, 30 Stat. 544-66 (repealed 1978), § 606(1) (defining "claim" for purposes of a Chapter XIII plan to exclude claims secured by estates in real property or chattels real); § 606(4) (defining "debt" to include all claims); and § 646(2) (permitting a Chapter XIII plan to "include provisions dealing with secured debts, severally, upon any terms"). The interplay of these three sections of the Bankruptcy Act meant that a Chapter XIII plan could deal with all secured debts *except* debts secured by real estate.

[8] *See* Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973), Part II, Chapter VI: Plans for Debtors with Regular Income, Part 2, Proceedings Relating to Plan and Performance Thereunder, §§ 6-201(2) (allowing modification of debt secured by personal property and cure of defaults within a reasonable time) and (4) (permitting cure of defaults within a reasonable time of claims secured by a lien on the debtor's

Code, as advanced in H.R. 8200, 95th Cong., 1st Sess. (1977), allowed a Chapter 13 plan to modify the rights of holders of secured or unsecured claims without limitation.[9] The Senate bill, S. 2266, preserved the protections afforded all real property lenders under Chapter XIII of the Act. The language of the Senate bill provided that a Chapter 13 plan could:

> (2) modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or of holders of unsecured claims.

S. 2266, 95th Cong., 2d Sess. § 1322(b)(2) (1978).

Section 1322(b)(2) as it was enacted in 1978 was a compromise of both the Senate and House bills: the anti-modification clause was limited to mortgages on a debtor's principal residence (instead of all real property) and the word "wholly" was changed to "only". This compromise position came about in response to "perceptions, or to suggestions advanced in the legislative hearings, . . . that,

residence) and notes thereto.

From 1973 through 1975, both houses of Congress introduced bills to revise the bankruptcy laws. The language of these bills (none of which was passed) more or less tracked the language of section 6-201. The bills introduced in 1977 and 1978 that were enacted in amended form as the Bankruptcy Code, H.R. 8200 (and its predecessors in 1977) and S. 2266, no longer tracked the language of section 6-201. *See* text *infra*.

[9] H.R. 8200, 95th Cong., 1st Sess. § 1322(b)(2) (1977) read as follows:

> Subject to subsections (a) and (c) of this section, the plan may--
>
> . . . .
>
> (2) modify the rights of holders of secured claims or of holders of unsecured claims; . . .

home-mortgagor [sic] lenders, performing a valuable social service through their loans, needed special protection against modification thereof (*i.e.*, reducing installment payments, secured valuations, etc.)." *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 246 (5th Cir. 1984) (en banc).[10] The compromise language of the present section 1322(b)(2) was thus adopted to preserve the protection that home mortgage lenders had under Chapter XIII and under the Senate bill but to limit that protection only to holders of claims secured by *home* mortgages.[11]

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[10] At Senate hearings held in 1977, representatives of mortgage lenders had expressed concern over the language of the House bill that allowed broad modification of the rights of home mortgage lenders. Edward J. Kulik, Senior Vice President, Real Estate Division, Massachusetts Mutual Life Insurance Co., testified that modifying a mortgagee's secured claim would have a significant negative impact on the home mortgage industry:

> The proposed chapter 13 in both bills, providing for the adjustment of debts of an individual with regular income, includes [a] fairly significant change[], compared to existing law, that may have the unintended effect of restricting the flow of home mortgage money.
>
> . . . .
>
> Serious consideration should be given to modifying [the House bill] so that, at the least . . . a mortgage on real property other than investment property may not be modified . . . .

Bankruptcy Reform Act of 1978: Hearings on S. 2266 and H.R. 8200 before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong., 1st Sess. 714 (1977).

[11] *See* 124 Cong. Rec. H11047 (daily ed. September 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17424 (daily ed. October 6, 1978) (statement of Sen. DeConcini) ("Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate amendment.")

The legislative history of section 1322(b)(2) supports the reading of the plain language of the statute: through the anti-modification clause, Congress intended to prohibit lienstripping with respect to home mortgage debt.

B. The legislative history of Chapter 12 and section 1222(b)(2), modelled on section 1322(b)(2), shows that Congress understood section 1322(b)(2) to prohibit a stripdown of the home mortgage.

In 1986, Congress enacted the "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986."[12] Among other things, this law added to the Bankruptcy Code a new chapter -- Chapter 12 -- that was intended to accommodate the financial problems of family farmers better than either Chapter 11 or Chapter 13.[13] Section 1322(b)(2) served as a model for section 1222(b)(2) with one important variation: section 1222(b)(2) lacks the anti-modification clause.[14]

Testimony by a leading academic, who was the executive director of the commission that proposed the Bankrupt-

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[12] Pub. L. No. 99-554, 100 Stat. 3088 (1986) (codified as amended in scattered sections of Titles 11 and 28 of the United States Code).

[13] *See* H. Rep. No. 958, 99th Cong., 2d Sess. 48 (1986).

[14] Section 1222(b)(2) reads as follows:

> (b) Subject to subsections (a) and (c) of this section, the plan may--
>
> . . . .
>
> (2) modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . .

11 U.S.C. § 1222(b)(2) (1988).

cy Code, and comments by a sponsor of the Chapter 12 legislation, suggest that the anti-modification clause of section 1322(b)(2) was understood to forbid "cramdown" or "lienstripping". Because Congress did intend to allow family farmers the right to strip down their debts secured by real estate that had declined in value, Congress did not include the anti-modification clause in section 1222(b)(2).

In the hearings on the bankruptcy provisions concerning the family farmer,[15] Prof. Frank R. Kennedy, who testified on behalf of the National Bankruptcy Conference, responded to a specific question regarding section 1322(b)(2) and its scope. Prof. Kennedy had served as executive director of the Commission on Bankruptcy Laws of the United States at the time of the passage of the Bankruptcy Code.[16] Responding to a letter from Rep. Rodino asking him to elaborate on the desirability of allowing a family

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[15] *Farm Bankruptcy Amendments: Hearing on H.R. 1397 and H.R. 1399 before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 99th Cong, 1st Sess. (1985) [hereinafter the "Farm Bankruptcy Amendments Hearing"].

[16] While, under the general principles of statutory interpretation, little, if any weight, is to be accorded the testimony of witnesses in legislative hearings, *Kelly v. Robinson*, 479 U.S. 36, 51 n.13 (1986), the testimony and statements of Prof. Kennedy merit more than usual consideration. Prof. Kennedy is a recognized expert in the bankruptcy area, had an academic career that spanned four decades, and played a leading role in bankruptcy reform. *See, e.g.*, 124 Cong. Rec. S17404 (daily ed. October 6, 1978) (remarks of Sen. DeConcini thanking Prof. Kennedy for his work on the bankruptcy legislation); Vern Countryman, "Frank R. Kennedy," 82 Mich. L. Rev. 195, 195 (1983) ("No one knows more about the law of debtor and creditor than Frank Kennedy.").

farmer to modify the secured debt on his residence, Prof. Kennedy wrote:

> Section 1322(b)(2) now precludes any modification of a claim secured only by real property that embraces the family farmer's home. *Thus, the debtor's plan of adjustment cannot reduce the amount of the principal or of any installment payable on such secured indebtedness and cannot extend the maturity date of the obligation or postpone the payment of any installment of the principal or interest.*[17]

It was against this background that Congress enacted section 1222(b)(2) to allow the family farmer to stripdown all secured debt. During Congressional debates on the proposed Senate bill, Sen. Grassley, a sponsor of the legislation, introduced into the Congressional Record the section-by-section analysis of the bill, which included the following regarding section 1222(b)(2):

> What must be in the plan comes primarily from chapter 11. What may be in the plan comes from both chapter 13 and chapter 11. In chapter 13 a debtor may not modify the mortgage on his residence (§ 1322(b)(2))--that provision was omitted and the debtor would be able to rearrange his home mortgage in chapter 12, just as he can in chapter 11.[18]

In passing Chapter 12, Congress recognized that it was affording broader relief to the family farmer than was ac-

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[17] Farm Bankruptcy Amendments Hearing at 130 (emphasis added).

[18] 132 Cong. Rec. S5557 (daily ed. May 7, 1986) (section-by-section analysis introduced into record by Sen. Grassley).

corded to other debtors under other chapters of the Bankruptcy Code. This broader relief included the right to strip down home mortgage liens, which Congress understood was unavailable in Chapter 13.[19]

[19] An amicus brief filed in support of Petitioners' position argues that bills introduced in 1992 in both houses of Congress indicate that Congress was aware that section 1322(b)(2), as written, does not prevent the stripdown of residential mortgages. Brief of Consumer Education and Protective Association, et al. as Amici Curiae in Support of Petitioners, pp. 42-45. This contention is not supported by the legislative history. The amendments to section 1322(b)(2) considered by Congress in 1992 simply recognized the split of the courts on the permissibility of cramdown and, if they indicate anything, it is that Congress intended to *clarify*, not change, the meaning of the section 1322(b)(2) anti-modification clause. *See* S. 1985, 102d Cong., 2d Sess. § 310 (1992); S. Rep. No. 279, 102d Cong., 2d Sess. 40-41 (1992) (indicating that the revision was "designed to *clarify* the Bankruptcy Code and congressional intent on the problem which is often referred to as "cramdowns" or "lien stripping". Currently caselaw is unsettled regarding the ability of the bankruptcy court to make a cramdown. . . . This section is designed to protect the entire claim in the case of first mortgages, not only that portion of the claim which would be secured pursuant to the status provided by section 506 of the code.") (emphasis added); *see also* H.R. 6020, 102d Cong., 2d Sess. § 202 (1992); H. Rep. No. 996, 102d Cong., 2d Sess. 21-22 (1992) (section-by-section analysis); *Consumer Issues in Bankruptcy: Hearing before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 102d Cong., 2d Sess. 3 (1992) (Rep. Hamilton Fish, Jr. stating, "[W]e need to make it clear, consistent with the recent Supreme Court decision regarding chapter 7, that a chapter 13 debtor can't 'cram down' or 'strip down' the value of his/her primary mortgage obligation.").

III. TO THE EXTENT THE LANGUAGE OF SECTION 1322'S ANTI-MODIFICATION CLAUSE MUST BE READ IN CONJUNCTION WITH SECTION 506, APPLICABLE LAW AND PRINCIPLES OF STATUTORY CONSTRUCTION CONFIRM THAT LIENSTRIPPING IS PROHIBITED.

A. Under the principle that specific statutory language governs over general language, the language of section 1322 supersedes section 506(a).

Section I.B. of this brief discussed the significant and adverse change to the rights of a home mortgage lender that results from mortgage cramdown. To the extent that the section 1322(b)(2) prohibition on mortgage cramdown conflicts with claim bifurcation under section 506(a), section 1322 must govern in a Chapter 13 case.

It is a basic principle of statutory construction that a specific statute controls over a more general statute.[20] Section 506 is a provision of general applicability in cases under Chapters 7, 11, 12, and 13 of the Bankruptcy Code. 11 U.S.C. § 103(a) (1988). Section 1322, however, applies only in Chapter 13 cases. 11 U.S.C. § 103(h)(1988). To the extent that section 1322(b)(2) is deemed to be inconsistent or contradictory with section 506(a), section

[20] *See Maiatico v. United States*, 302 F.2d 880, 886 (D.C. Cir. 1962); *In re Schum*, 112 B.R. 159, 160-61 (Bankr. N.D. Tex. 1990); *In re Sauber*, 115 B.R. 197, 199 (Bankr. D. Minn. 1990); *In re Lee*, 35 B.R. 452, 456 (Bankr. N.D. Ga. 1983) (all provisions of Chapter 1, 2, and 5 cannot be applied with identical force to each of Chapter 7, 11, and 13).

1322(b)(2) must be read to supersede section 506(a).[21] Thus, should the Court decide that stripdown of a home mortgage lien is prohibited under section 1322(b)(2) but that section 506(a) does apply to bifurcate a lender's claim, the specific prohibition of section 1322(b)(2) must take precedence over the general application of section 506.

B. If the language of section 1322's anti-modification clause is to be read in light of section 506, the reading must include section 506(d), which *Dewsnup* held prohibits lienstripping.

If the Court accepts the argument that sections 506(a) and 1322(b)(2) can be read together without conflict, such that a "claim secured by" a security interest in the anti-modification clause of section 1322(b)(2) equates to an "allowed secured claim" (one of the products of bifurcation under section 506(a)), this reading does not result in the conclusion that the Chapter 13 debtor's home mortgage lien may be stripped down. If section 1322(b)(2) and section 506(a) indeed mean that only a secured lender's "allowed secured claim" is protected from modification, the mortgagee's lien will be voided to the extent that it exceeds the value of the collateral only if section 506(d) applies to that lien. This Court did state in *Dewsnup*, however, that when "the claim . . . has been 'allowed' pursuant to § 502 of the Code and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of § 506

[21] *See In re Russell*, 93 B.R. 703, 705 (D.N.D. 1988); *In re Hynson*, 66 B.R. 246, 249-50 (Bankr. D.N.J. 1986); *In re Hemsing*, 75 B.R. 689 (Bankr. D. Mont. 1987).

(d), which voids only liens corresponding to claims that have *not* been allowed and secured." 112 S. Ct. at 777 (emphasis in original). Thus, under section 506(d), if a home mortgage lender's claim has been allowed and is secured, the lender's lien cannot be stripped down.

The Court in *Dewsnup* recognized that, "[u]nder the Bankruptcy Act of 1898, a lien on real property passed through bankruptcy unaffected." *Id.* at 778-79. Because Congress enacted the Code "with a full understanding of th[e] practice" that accorded respect to a secured lender's lien, this principle continues to be valid under the Code. *Id.* at 779. "Ordinarily, liens and other secured interests survive bankruptcy." *Farrey v. Sanderfoot*, 111 S. Ct. 1825, 1829 (1991). "[A] bankruptcy discharge extinguishes only one mode of enforcing a claim -- namely, an action against the debtor *in personam* -- while leaving intact another -- namely an action against the debtor *in rem*." *Johnson v. Home State Bank*, 111 S. Ct. 2150, 2154 (1991).

The same policies that prohibit cramdown in a Chapter 7 are applicable to a Chapter 13 bankruptcy. Section 506(d) does not allow cramdown of a claim that has been allowed and is secured in a Chapter 7 case and likewise does not allow cramdown of such a claim in a Chapter 13 case.

IV. READING SECTION 1322(b)(2) TO PROHIBIT CRAMDOWN OF RESIDENTIAL MORTGAGES IS CONSISTENT WITH THE PURPOSES OF CHAPTER 13 AS A WHOLE.

Only the debtor may propose a plan under Chapter 13.[22] Thus, any limitations on provisions of a plan must be for the benefit of creditors rather than for the benefit of the debtor. *In re Hall*, 117 B.R. 425, 428 (Bankr. S.D. Ind. 1990). Yet the reading that Petitioners and amici give to section 1322(b)(2) does not further the purposes of section 1322(b)(2) or of Chapter 13: it results in no immediate benefit to the Chapter 13 debtor, does not increase the return to other creditors, and at the same time affords virtually no protection to the home mortgage lender.

Chapter 13 is designed to reduce an individual debtor's debt burden to an amount that he can pay out of his future income, while allowing him to keep assets beyond the exemptions allowed in a Chapter 7 liquidation. The Chapter 13 debtor proposes a plan under which all of his disposable income for a period of 36 to 60 months is devoted to paying past debt.[23] Upon completion of payments under the plan, the debtor is discharged of the debts that are treated under the plan.

As shown in Section I.B. of this brief, Petitioners' interpretation of section 1322(b)(2) preserves few of the rights of the home mortgagee. At the same time, their reading results in no immediate benefit to the debtor, since they agree that installment payments must continue at the

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[22] "The debtor shall file a plan." 11 U.S.C. § 1321 (1988).

[23] *See* 11 U.S.C. §§ 1322(a)(1) and (c) (1988).

full amount set forth in the loan agreement. Furthermore, other creditors are harmed as a result of bifurcation of the mortgagee's claim: the mortgagee now has an unsecured deficiency claim and any distribution on the mortgagee's unsecured claim reduces the amount paid to other unsecured creditors. The benefit that Petitioners and amici see from cramdown of a mortgage claim -- the "light at the end of the tunnel" that results from an earlier retirement of the mortgage debt[24] -- is (in most instances) a benefit that accrues *solely* to the debtor. As this Court stated in *Dewsnup*, there is no evidence that Congress intended such a result. 112 S. Ct. at 778.[25]

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[24] Petitioners' Brief at 7.

[25] Amici who have filed briefs in support of Petitioners' position emphasize the situation of debtors who have senior and junior mortgages on their homes. The case before this Court, however, involves cramdown of a primary, purchase-money home mortgage, and the issue presented is the extent of protection granted by the anti-modification clause to claims falling within its scope -- that is, the permissibility of claim bifurcation and lienstripping with regard to home mortgage debt. The scope of the anti-modification clause -- whether or not section 1322(b)(2) protects primary and junior (purchase- and non-purchase money) mortgage loans or only primary mortgage loans -- is a question distinct from the question before the Court in this case. *See, e.g., In re Diquinzio*, 110 B.R. 628 (Bankr. D.R.I. 1990); *In re Shaffer*, 84 B.R. 63, 66 (Bankr. W.D. Va.), *aff'd and remanded on other grounds*, 116 B.R. 60 (W.D. Va. 1988).

Congress encouraged home equity loans as a result of the Tax Reform Act of 1986, Pub. L. No. 99-524, § 1231(e)(1), 100 Stat. 2085 (1986), which phased out the deduction for interest paid on consumer debt but allows a deduction for interest paid on home mortgage debt. If it determines to limit the protection of section 1322 as to junior and nonpurchase-money mortgagees, Congress can do so. But purchase-money home mortgagees should not be deprived of that protection simply because of the recent growth of home equity loans.

V. READING SECTION 1322(b)(2) TO PROHIBIT CRAMDOWN OF RESIDENTIAL MORTGAGES IS CONSISTENT WITH THE TREATMENT SUCH MORTGAGES WOULD RECEIVE UNDER CHAPTERS 7 AND 11 OF THE BANKRUPTCY CODE.

"A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme. . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Savings Association v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988). A comparison of the treatment of an undersecured home mortgage lender's claim in Chapters 7, 11 and 13 indicates that home mortgage stripdown in Chapter 13 would be contrary to, and incompatible with, the result in Chapters 7 and 11.

Chapter 7. Under *Dewsnup*, a Chapter 7 debtor may not use sections 506(a) and (d) to avoid the portion of a mortgage lien that exceeds the value of the property. As a result, the Chapter 7 undersecured mortgage creditor is allowed to realize the full value received upon sale of the property up to the amount of its lien.

Chapter 11. In Chapter 11, now open even to individuals not actively engaged in business, *Toibb v. Radloff*, 111 S. Ct. 2197 (1991), the undersecured mortgage creditor has a choice if the debtor decides to retain the property securing the creditor. Under the first option, pursuant to section 1111(b)(1)(A), the undersecured creditor's claim, whether a recourse or nonrecourse obligation, will be treated as a secured claim to the extent of the value of the collateral and as an unsecured claim to the extent that the claim

exceeds the value of the collateral. As to its secured claim, under section 1129(b)(2)(A) the creditor must receive a stream of payments having a present value equal to the value of the collateral. The creditor's unsecured claim will receive the same distribution as other unsecured claims under the Chapter 11 plan.

There is, however, a second option open to the undersecured creditor. Under section 1111(b)(2), the undersecured creditor may elect to forego its unsecured claim (and a distribution on that claim) and "notwithstanding section 506(a) of this title, such claim [of the creditor] is a secured claim to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2) (1988). Thus, under section 1111(b)(2) the undersecured creditor may decide to retain its lien for the full amount of its claim, in which event it will receive payments equal to the full value of its claim with a present value equal to the amount of its interest in the estate's interest in the collateral. 11 U.S.C. § 1129(a)(7)(B) (1988).

The undersecured creditor may decide to make the section 1111(b)(2) election in a number of circumstances. It may believe that the bankruptcy court's valuation of the property in question, for purposes of determining the secured and unsecured portions of its claim under section 506(a), was too low. Too low a valuation (resulting in too small a secured claim) in combination with a small (or no) distribution to unsecured creditors may make it more profitable for a creditor to forego its unsecured claim in order to retain a lien for the full amount of its claim. Undersecured creditors will elect the section 1111(b)(2) option if they believe that the property was undervalued or valued in a declining market and is likely to appreciate in value and

if they further believe that the debtor will sell the property or will default on its obligations once out of bankruptcy.[26]

Thus, in Chapter 11, an undersecured lender will not see its secured interest, or lien, reduced involuntarily. Section 1111(b)(2) allows the undersecured creditor in Chapter 11 the option of retaining its lien for the full amount of its claim if the creditor believes that it will be to its benefit to do so.[27]

Chapter 13. Under the position advanced by Petitioners, a Chapter 13 debtor would be able to pay only a portion of what is due to the undersecured home mortgage lender, as fixed in a valuation hearing before plan confirmation, and retain for himself all the benefits of a subsequent increase in value of the residential property. Under the position advocated by Respondent and amicus Fannie

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[26] Most home mortgages, for example, contain a due-on-sale clause, because mortgage purchasers in the secondary market, like Fannie Mae and the Federal Home Loan Mortgage Corporation, require such a provision if the mortgage is to be eligible for purchase. Thus, if the property is sold after the bankruptcy case, the mortgagee will have the right to be paid, upon such sale, to the full extent of its lien.

[27] Section 1111 was enacted in reaction to pre-Code decisions in *In re Pine Gate Assocs., Ltd.*, No. B75-4345A (N.D. Ga.), dating from the mid-1970s. *See* 5 *Collier on Bankruptcy* ¶ 1111.02 at 1111-21 (15th ed. 1988). In that case, under Chapter XII of the Bankruptcy Act, a real estate lender held a nonrecourse note secured by an apartment complex worth less than the amount of the debt. Debtor proposed to satisfy the lender's claim by paying to the lender an amount equal to the current value of the property, but paying nothing on any deficiency claim. Debtor was thus able to eliminate the lender in a slumping real estate market and be the sole beneficiary in a rising market. Section 1111(b) obviates the evils of the *Pine Gate* scenario by giving the undersecured creditor a choice.

Mae, a home mortgagee would retain the same rights in Chapter 13 that it has outside of bankruptcy: the mortgagee would be paid under the terms of its mortgage loan by the Chapter 13 debtor or would have the right to foreclose on the property. The retention of the full mortgage lien is consistent with the rights of secured lenders in Chapters 7 and 11. There is no indication that Congress enacted section 1322(b)(2) to provide a windfall to the Chapter 13 debtor, at the expense of the secured lender and possibly other unsecured creditors, which is the outcome under Petitioners' reading of that provision.

Chapter 20. An individual who filed a Chapter 7 bankruptcy petition may subsequently file a Chapter 13 petition.[28] Under Petitioners' reading of section 1322(b)(2), Chapter 13 may become a haven for those individuals seeking to strip down their home mortgages -- whether or not such individuals are initially eligible for Chapter 13.

An individual who might not initially be eligible for Chapter 13 may decide to file serial petitions in Chapter 7 and then in Chapter 13, a Chapter "20", in order to take advantage of the stripdown afforded by Chapter 13 under Petitioners' reading of that section. First, the debtor would file a Chapter 7 petition to obtain a discharge of unsecured debts that make the debtor ineligible for Chapter 13 or, as in *Johnson*, to eliminate the debtor's recourse liability on a mortgage. Although under *Dewsnup* the debtor will not be able to strip down his home mortgage lien in the Chapter 7

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[28] *Johnson v. Home State Bank*, 111 S. Ct. 2150, 2156 (1991) ("Congress did not intend categorically to foreclose the benefit of Chapter 13 reorganization to a debtor who previously has filed for Chapter 7 relief.").

proceeding, immediately after obtaining a discharge in Chapter 7 (before the secured mortgage lender can exercise its rights of foreclosure), the debtor can then file a Chapter 13 petition in order to keep his home -- and stripdown the mortgagee's lien.

In sum, lienstripping in Chapter 13 would result in less protection to the home mortgage lender in a Chapter 13 case, where Congress intended to protect home mortgage lenders, than in a Chapter 7 or 11 case. There is no indication that Congress intended that a debtor's choice of bankruptcy proceeding should result in such disparate treatment of a home mortgage lender.

CONCLUSION

The anti-modification clause of section 1322(b)(2) of the Bankruptcy Code protects the rights of the holder of a home mortgage claim to the full extent of the claim. The lower courts and the Fifth Circuit in this case have correctly interpreted the provision to prohibit cramdown of a home mortgage claim and lienstripping. This reading of the statute is consistent with the legislative history and with the purpose of Chapter 13 and of the Bankruptcy Code as a whole. The judgment of the Fifth Circuit should be affirmed.

Respectfully submitted,

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